ST 96-9
TAX TYPE: SALES TAX
ISSUE: MACHINERY & EQUIPMENT EXEMPTION - MANUFACTURING

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE	)	Docket #
OF THE STATE OF ILLINOIS	)	IBT #
	)	CLAIM FOR CREDIT
v.	)	
	)	NTL #
TAXPAYER	)	Barbara S. Rowe
Taxpayer	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: ATTORNEYS FOR TAXPAYER; JERILYNN GORDEN, STAFF ATTORNEY FOR THE ILLINOIS DEPARTMENT OF REVENUE AND MARK DYCKMAN, SPECIAL ASSISTANT ATTORNEY GENERAL FOR THE ILLINOIS DEPARTMENT OF REVENUE.

Synopsis:

THIS MATTER COMES FOR HEARING FOLLOWING THE TIMELY PROTEST BY TAXPAYER (THE "TAXPAYER") OF THE DEPARTMENT'S NOTICE OF TENTATIVE DETERMINATION OF CLAIM DENYING THE TAXPAYER'S CLAIM FOR CREDIT FOR THE PERIOD OF JANUARY, 1988 THROUGH DECEMBER, 1990 AS WELL AS , AS WELL AS THE TAXPAYER'S TIMELY PROTEST TO A NOTICE OF TAX LIABILITY ISSUED BY THE ILLINOIS DEPARTMENT OF REVENUE (THE "DEPARTMENT") FOR THE PERIOD JANUARY, 1991 THROUGH MARCH, 1993.

THE TAXPAYER WAS AUDITED BY THE DEPARTMENT AND AS A RESULT, WAS ASSESSED USE TAX PURSUANT TO THE ILLINOIS USE TAX ACT (35 ILCS 105/1 ET SEQ.) WITH RESPECT TO THE PURCHASE OF A HOT-MIX ASPHALT PAVING PLANT AS WELL AS CERTAIN POLLUTION CONTROL EQUIPMENT. THE AUDIT PERIOD WAS JANUARY, 1988

through December, 1990. The taxpayer paid the assessment and timely filed a claim for credit claiming that the asphalt plant and pollution control equipment qualify for exemption from the Use Tax Act pursuant to 35 ILCS 105/3-5(18) and 35 ILCS 105/2A. The Department denied the claim.

During a subsequent audit, covering the time period January, 1991 through March, 1993, the taxpayer was assessed use tax for its purchases of parts and machinery for the repair and maintenance of the hot-mix asphalt plant. The taxpayer timely protested the Notice of Tax Liability issued as a result of that audit and requested a hearing.

Prior to the hearing, the parties entered into joint stipulations wherein they agreed that $9,981.00 of the claim for credit is attributable to taxes and interest paid for pollution control equipment that is exempt from use tax.

At issue is whether the hot-mix asphalt plant, as well as the equipment and parts purchased for the maintenance and repair of the plant, are exempt from the imposition of use tax pursuant to the manufacturing and assembling machinery and equipment exemption of the Use Tax Act. Following the submission of all evidence and a review of the record, it is recommended that the matter be resolved in favor of the Department.

Findings of Fact:

1. The Department's prima facie case was established by the admission into evidence of the Notice of the Department's Tentative Determination of Claim, issued on December 26, 1991 (Dept. Ex. No. 1) and the Correction and/or Determination of Tax Due for the period of January 1, 1991 through March 31, 1993. (Dept. Ex. No. 2; Tr. pp. 6-7)

2. The Taxpayer manufactures hot-mix asphalt. (Joint Stip. Ex. No. 1, ¶ 2)

3. The Taxpayer manufactures the asphalt in a hot-mix asphalt plant which it purchased. (Joint Stip. Ex. No. 1 ¶ 5; Joint Stip. Ex. No. 2 ¶ 5)

4. The Taxpayer did not pay Illinois use tax for its purchase of the asphalt plant. (Joint Stip. Ex. No. 1 A)

5. The asphalt plant combines raw ingredients consisting of coarse and fine aggregates with the asphalt cement required to produce the hot-mix asphalt. (Joint Stip. Ex. No. 1 ¶ 5; Joint Stip. Ex. No. 2 ¶ 5)

6. The asphalt plant is used exclusively to produce asphalt. (Joint Stip. Ex. No. 1 ¶ 12)

7. The asphalt discharged by the asphalt plant is tangible personal property. (Joint. Stip. Ex. No. 1 ¶ 5; Joint Stip. Ex. No. 2 ¶ 5)

8. The Taxpayer holds itself out to the general public as a seller of asphalt. (Tr. p. 19)

9. The Taxpayer sells approximately twenty per cent (20%) of the asphalt to retail customers and private contractors. (Joint Stip. No. 1 ¶ 17)

10. In addition to being a retailer of asphalt, Taxpayer is a construction contractor, entering into contracts wherein it paves roads, highways, streets, parking lots, driveways, sports surfaces and other such projects for governmental and non-governmental entities. (Joint Stip. Ex. No. 1 ¶ 17; Joint Stip. Ex. No. 1 B-E)

11. The Taxpayer used eighty percent (80%) of the asphalt produced in the plant to fulfill its own contracts to pave roads, highways, streets, parking lots, driveways, sports surfaces and other such projects. (Joint Stip. Ex. No. 1 ¶ 17)

12. Taxpayer uses none of the asphalt that it produces on property that it owns of leases. (Joint Stip. Ex. No. 1 ¶ 12)

13. The Department conducted an audit of the Taxpayer for the period of January 1, 1988 through December 31, 1990. (Joint Stip. Ex. No. 1 ¶ 3)

14. As a result of the audit, the Department assessed the Taxpayer use tax for the purchase of the hot-mix asphalt plant. (Joint Stip. Ex. No. 1 ¶ 4)

15. The Taxpayer paid the Department more than $60,086.00 pursuant to this audit and timely filed a claim for credit for this amount. (Joint Stip. Ex. No. 1, ¶¶ 4, 6)

16. The Department denied the claim, to which the Taxpayer timely filed a protest with a request for a hearing. (Dept. Ex. No. 1; Joint Stip. Ex. No. 1 ¶ 7)

17. For the tax period of January, 1991 through March 31, 1993, the Department issued a notice of tax liability for use tax not paid by this Taxpayer for equipment, parts and machinery used in the repair and maintenance of the asphalt plant. (Joint Stip. Ex. No. 1 ¶ 9)

18. Taxpayer protested the notice of tax liability and requested a hearing. (Joint Stip. Ex. No. 1 ¶ 8)

19. There is no issue regarding the accuracy of the calculations should it be determined that use tax should be assessed against the asphalt plant. (Joint Stip. Ex. No. 1 ¶ 10)

20. The parties agree that $9,981.00 of the amount filed by Taxpayer as a claim for credit is attributable to the taxes and interest paid for pollution control equipment which is exempt from the application

OF USE TAX AS POLLUTION CONTROL FACILITIES PURSUANT TO 35 ILCS 105/2A. (JOINT STIP. EX. NO. 1 ¶ 11)

Conclusions of Law:

THE ISSUE TO BE DECIDED HEREIN IS WHETHER THE MACHINE KNOWN AS A HOT-MIX ASPHALT PAVING PLANT, WHICH PRODUCES HOT-MIX ASPHALT, IS EXEMPT FROM THE IMPOSITION OF ILLINOIS USE TAX. THE USE TAX ACT IMPOSES A TAX "UPON THE PRIVILEGE OF USING IN THIS STATE TANGIBLE PERSONAL PROPERTY PURCHASED AT RETAIL FROM A RETAILER... ." 35 ILCS 105/3 THERE IS NO QUESTION THAT TAXPAYER'S PURCHASE OF THE MACHINERY AT ISSUE IS, UNDER THE USE TAX ACT, SUBJECT TO THE IMPOSITION OF THE TAX. HOWEVER, THE LEGISLATURE HAS PROVIDED CERTAIN EXEMPTIONS FROM THE IMPOSITION OF THE TAX. THE PERTINENT EXEMPTION CLAIMED BY TAXPAYER READS, AS FOLLOWS:

> § 3-5. EXEMPTIONS. USE OF THE FOLLOWING TANGIBLE PERSONAL PROPERTY IS EXEMPT FROM THE TAX IMPOSED BY THIS ACT:
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> (18) MANUFACTURING AND ASSEMBLING MACHINERY AND EQUIPMENT USED PRIMARILY IN THE PROCESS OF MANUFACTURING OR ASSEMBLING TANGIBLE PERSONAL PROPERTY FOR WHOLESALE OR RETAIL SALE OR LEASE, WHETHER THAT SALE OR LEASE IS MADE DIRECTLY BY THE MANUFACTURER OR BY SOME OTHER PERSON, WHETHER THE SALE OR LEASE IS MADE DIRECTLY BY THE MANUFACTURER OR BY SOME OTHER PERSON, WHETHER THE MATERIALS USED IN THE PROCESS ARE OWNED BY THE MANUFACTURER OR SOME OTHER PERSON, OR WHETHER THAT SALE OR LEASE IS MAKE APART FROM OR AS AN INCIDENT TO THE SELLER'S ENGAGING IN THE SERVICE OCCUPATION OF PRODUCING MACHINES, TOOLS, DIES, JIGS, PATTERNS, GAUGES, OR OTHER SIMILAR ITEMS OR NO COMMERCIAL VALUE ON SPECIAL ORDER FOR A PARTICULAR PURCHASER. (EMPHASIS ADDED)

35 ILCS 105/3-5 (18)[1]

ARTICLE IX OF THE ILLINOIS CONSTITUTION SUBJECTS ALL PROPERTY TO TAXATION. SECTION 3 OF THAT ARTICLE ALLOWS THE LEGISLATURE TO EXEMPT CERTAIN PROPERTY, BUT THE PROVISION IS NOT SELF-EXECUTING AND EXEMPTIONS EXIST ONLY WHEN CREATED BY A GENERAL LAW ENACTED BY THE LEGISLATURE. (NORTHSHORE POST NO. 21 V. KORZEN, 38 ILL.2D 231 (1967))

STATUTES EXEMPTING PROPERTY FROM TAXATION MUST BE STRICTLY CONSTRUED AND CANNOT BE EXTENDED BY JUDICIAL INTERPRETATION. IN DETERMINING WHETHER PROPERTY IS INCLUDED WITHIN THE SCOPE OF A TAX EXEMPTION ALL FACTS ARE TO BE CONSTRUED AND ALL DEBATABLE QUESTIONS ARE TO BE RESOLVED IN FAVOR OF TAXATION. EVERY PRESUMPTION IS AGAINST THE INTENTION OF THE STATE TO EXEMPT PROPERTY FROM TAXATION. (FOLLETT'S ILLINOIS BOOK & SUPPLY STORE, INC. V. ISSACS, 27 ILL.2D 600 (1963)) FOR THE PURPOSES OF THIS DISCUSSION, BY THE VERY LANGUAGE OF THE STATUTE, THIS EXEMPTION FROM THE APPLICATION OF USE TAX APPLIES ONLY WHEN THE MACHINERY OR EQUIPMENT IS USED 1) PRIMARILY TO MANUFACTURE 2) TANGIBLE PERSONAL PROPERTY 3) FOR WHOLESALE OR RETAIL SALE OR LEASE.

THERE IS NO DISPUTE THAT TAXPAYER PURCHASED THIS MACHINERY FOR THE SOLE PURPOSE OF CREATING HOT-MIX ASPHALT FROM RAW INGREDIENTS. THE CREATION OF THIS ASPHALT IS A MANUFACTURING PROCESS. FURTHER, THE PARTIES AGREE THAT THE ASPHALT, AS DISCHARGED FROM THE ASPHALT PLANT, IS TANGIBLE PERSONAL PROPERTY. AT ISSUE, THEN, IS THE REQUIREMENT THAT THE MACHINERY BE USED PRIMARILY TO MANUFACTURE TANGIBLE PERSONAL PROPERTY FOR WHOLESALE OR RETAIL SALE OR LEASE. IT IS, IN FACT, THIS STATUTORY REQUIREMENT THAT TAXPAYER FAILS TO MEET, THUS RENDERING THE EXEMPTION INAPPLICABLE.

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1. There is a corresponding exemption found in the Retailers' Occupation Tax Act at 35 **ILCS** 120/2-5 (14). For purposes of this discussion, there is no difference between the two statutory provisions. The repair parts purchased for the exempt machinery and equipment are also exempt.

Taxpayer is a business with two distinct components. First, it manufactures asphalt which it sells to retail customers and to private contractors. In this respect, it functions similarly to the taxpayer in Van's Material Company, Inc. v. Department of Revenue, 131 Ill.2d 196 (1989). The Van's taxpayer combined raw material in the hollow drum mixers on ready-mix concrete trucks. In so doing, ready-mix concrete was manufactured. (Id. at 209) That taxpayer then unloaded the produced concrete at the purchaser's delivery site. All that Van's did was manufacture, sell and deliver the concrete to its purchaser who used the concrete to form real estate. (Id. at 217)

The Illinois Supreme Court held that the machinery and equipment at issue in Van's was exempt from the imposition of use tax and retailer's occupation tax as that taxpayer proved that it used the machinery to primarily manufacture tangible personal property which it sold.

Van's, however, has limited application in this matter. Taxpayer sells only twenty percent (20%) of the asphalt it manufactures to its customers, in contrast to Van's having sold one hundred percent (100%) of the product it manufactured. As to the 20% sold, taxpayer can rely on Van's for support for its assertion of exemption. However, the statute mandates more.

Primarily, this taxpayer uses the machinery at issue to produce asphalt for its own use in satisfying its obligations as a construction contractor. The taxpayer provides several sample contracts between itself and governmental and non-governmental entities.[2] These customers

[2]. Joint Stipulation Ex. No. 1 B is a contract for the grading and paving of a particular roadway for the Illinois Department of Transportation according to certain specifications; Joint Stipulation Ex. No. 1 C represents the contract and specification documents for improvements to a roadway for a governmental client; Joint Stipulation Ex. No. 1 D represents a subcontracting contract between the taxpayer and a contracting client for the improvement to a parking lot with a base, a surface and a curb; Joint Stipulation Ex. No. 1 E is a

HAVE CONTRACTED WITH TAXPAYER FOR THE CONSTRUCTION OF A ROAD, HIGHWAY, DRIVEWAY OR SIMILAR PRODUCT, ALL OF WHICH ARE DEEMED TO BE REAL ESTATE. IN THIS RESPECT, TAXPAYER FUNCTIONS IN EXACTLY THE SAME MANNER AS DID THE TAXPAYER IN T.M. MADDEN & CO. V. DEPARTMENT OF REVENUE, 272 ILL. APP.3D 212 (2ND DIST. 1995). THE MADDEN TAXPAYER ASSERTED THAT THE EQUIPMENT KNOWN AS A SLIP FORM PAVER QUALIFIED FOR AN EXEMPTION FROM THE USE TAX ACT UNDER THE SAME MANUFACTURING EXEMPTION CLAIMED HEREIN AND RELIED ON VAN'S MATERIAL CO., SUPRA, TO SUPPORT ITS CLAIM. THE EVIDENCE OF RECORD WAS EXHAUSTIVE REGARDING THE PROCESS EFFECTUATED BY THE PAVER IN TURNING THE RAW CEMENT DUMPED AT THE SITE INTO THE FINISHED ROADWAY.

NONETHELESS, THE MADDEN COURT DENIED THAT TAXPAYER THE EXEMPTION DESPITE THE FACT THAT THE RAW CONCRETE TRANSFORMED BY THE PAVER WAS DEEMED TO BE TANGIBLE PERSONAL PROPERTY WHEN DELIVERED TO THAT TAXPAYER AT THE JOB SITE. THE EXEMPTION FAILED BECAUSE THE STATUTE REQUIRES THAT THE MACHINERY MUST MANUFACTURE TANGIBLE PERSONAL PROPERTY. THE MADDEN PAVER MANUFACTURED A ROADWAY, WHICH IS REAL ESTATE, NOT TANGIBLE PERSONAL PROPERTY. T.M. MADDEN & CO. V. DEPARTMENT OF REVENUE, SUPRA AT 217

THE MADDEN COURT SAID THAT "[I]T IS THE PURPOSE FOR WHICH PROPERTY IS SOLD THAT IS DETERMINATIVE." ID. AT 218 AND, THAT COURT FOUND THAT WHAT THAT TAXPAYER WAS SELLING TO THE ILLINOIS DEPARTMENT OF TRANSPORTATION WAS NOT TANGIBLE PERSONAL PROPERTY AS IT ASSERTED, BUT WAS A ROAD. ID. AT 218

THE MADDEN COURT DENIED THE EXEMPTION BECAUSE THE EQUIPMENT AT ISSUE DID NOT MANUFACTURE TANGIBLE PERSONAL PROPERTY AS REQUIRED BY THE

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contract between the taxpayer, as a subcontractor, and a construction company for pavement installation and improvements with standard specifications.

STATUTE. HERE, THE TAXPAYER ACTS AS A MADDEN-TYPE CONSTRUCTION CONTRACTOR. APPROXIMATELY 80% OF THE ASPHALT PRODUCED BY THE ASPHALT PLANT IS USED BY TAXPAYER TO CONSTRUCT ROADS OR MAKE IMPROVEMENTS TO REAL ESTATE. THUS, 80% OF THE ASPHALT PRODUCED BY THE MACHINERY IS NOT TANGIBLE PERSONAL PROPERTY FOR WHOLESALE OR RETAIL SALE OR LEASE AS REQUIRED BY THE EXEMPTING STATUTE.

THE CONTRACTS PROVIDED BY THIS TAXPAYER IN THIS MATTER VERIFY THAT THE ILLINOIS DEPARTMENT OF TRANSPORTATION AND THE TAXPAYER'S OTHER CLIENTS CONTRACT WITH IT FOR THE CREATION OR IMPROVEMENTS TO ROADS, HIGHWAYS AND SIMILAR REAL ESTATE, JUST AS THE DEPARTMENT OF TRANSPORTATION CONTRACTED WITH MADDEN FOR THE CREATION OF ROADWAYS. IN SO SATISFYING ITS CONTRACTUAL OBLIGATIONS, THE TAXPAYER IS THE USER OF THE ASPHALT PRODUCED. NOTWITHSTANDING TAXPAYER'S ASSERTIONS TO THE CONTRARY, TAXPAYER ACTS, IN TERMS OF ITS USE OF THE ASPHALT, IN EXACTLY THE SAME MANNER AS THE CONSTRUCTION CONTRACTOR WHO BUILDS A HOME FOR ITS CUSTOMER ON PROPERTY OWNED BY THE CUSTOMER.

IN THE CASE OF MATERIAL SERVICE CORPORATION V. ISSACS, 25 ILL.2D 137 (1962), THE ILLINOIS SUPREME COURT DETERMINED THAT THE SALE OF BUILDING MATERIALS TO A CONSTRUCTION CONTRACTOR WHO IMPROVES REAL ESTATE OWNED BY HIS CUSTOMER IS A TAXABLE TRANSACTION UNDER THE RETAILER'S OCCUPATION TAX ACT. IN THAT CASE, TAXPAYERS ARGUED THAT THE RETAILER'S OCCUPATION TAX ACT WAS A TAX IMPOSED UPON PERSONS ENGAGED IN THE BUSINESS OF SELLING TANGIBLE PERSONAL PROPERTY AT RETAIL, AND THAT IN ORDER TO SUSTAIN THE TAX THE PROPERTY MUST HAVE BEEN PURCHASED FOR USE OR CONSUMPTION AND NOT BOUGHT FOR RESALE IN ANY FORM AS TANGIBLE PERSONAL PROPERTY. ID. AT 139 TAXPAYERS THEREIN CLAIMED THAT THE MATERIALS IT PURCHASED WERE FOR RESALE.

THE SUPREME COURT IN MATERIAL SERVICE SPECIFICALLY FOUND THAT "[T]HE SALES TO THE CONTRACTOR ARE NOT FOR RESALE AS TANGIBLE PERSONAL PROPERTY BUT FOR HIS OWN USE OR CONSUMPTION" (ID. AT 141) AND ARE, THEREFORE, TAXABLE TRANSACTIONS. IN ACCORD IS CRAFTMASTERS V. DEPARTMENT OF REVENUE, 269 ILL. APP.3D 934 (4TH DIST. 1995), WHERE PLAINTIFF, A BUILDING CONTRACTOR, INCORPORATED BUILDING MATERIALS, INTER ALIA, INTO HIS CUSTOMER'S REAL ESTATE VIA REMODELING, REHABILITATION WORK AND CONSTRUCTION. THE COURT STATED THAT "[A] CONTRACTOR'S INCORPORATION OF BUILDING MATERIALS INTO REAL ESTATE IS A USE OF THE MATERIALS BY THE CONTRACTOR AND NOT A SALE OF THE MATERIALS TO THE CONTRACTOR'S CUSTOMER." ID. AT 940 CITING AS AUTHORITY MATERIAL SERVICE CORP. V. ISSACS, SUPRA, AND G.S. LYON & SONS CO. V. DEPARTMENT OF REVENUE, 23 ILL.2D 177 (1961). IN MAKING ITS DETERMINATION, THE COURT FOLLOWED THE REASONING DEVELOPED IN MODERN DAIRY CO. V. DEPARTMENT OF REVENUE, 413 ILL. 55 (1952) WHICH IS THAT THE "USE" OF TANGIBLE PERSONAL PROPERTY INCLUDES "ANY EMPLOYMENT OF A THING WHICH TAKES IT OFF THE RETAIL MARKET SO THAT IT IS NO LONGER AN OBJECT OF THE TAX." ID. AT 139; MODERN DAIRY, SUPRA AT 66 THE MATERIAL SERVICE COURT ALSO AFFIRMED THE REASONING EMPLOYED IN THE CASE, G. S. LYON & SONS CO. V. DEPARTMENT OF REVENUE, SUPRA, WHICH APPLIED THE REASONING OF MODERN DAIRY TO SALES OF MATERIALS TO SPECULATIVE BUILDERS.

IN LYON, THE SUPREME COURT FOUND THAT SALES OF MATERIALS TO REAL ESTATE DEVELOPERS AND SPECULATIVE BUILDERS, WHICH WERE USED TO BUILD HOMES WHICH WERE THEN SOLD, WERE TAXABLE SALES AS THE BUILDERS WERE THE USERS OF THE PROPERTY.[3] THE THOUGHT PROCESS OF THE LYON COURT IS PARTICULARLY INSIGHTFUL HERE. THAT COURT SAID, IN PERTINENT PART:

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[3]. The Court in Material Service Corp. did not find significance in the fact that the taxpayers in Lyon were speculative builders and developers who owned the real estate at the time of the purchase of the material and the taxpayers in Material Service improved real estate owned by their customers.

> THE PROCESS OR EMPLOYMENT ENGAGED IN BY A BUILDER RESULTS IN DESTROYING THE IDENTITY OF THE MATERIAL AS PERSONAL PROPERTY AND CONVERTING IT INTO REAL ESTATE. USING THEM FOR PURPOSES OF CONSTRUCTION OBVIOUSLY TAKES THE MATERIALS AS SUCH OFF THE RETAIL MARKET, AND SINCE THE ACT [RETAILER'S OCCUPATION TAX ACT] HAS NO APPLICATION TO SALES OF REAL ESTATE, THE MATERIALS OF WHICH IMPROVEMENTS ARE CONSTRUCTED CAN NO LONGER BE AN OBJECT OF THE TAX.

ID. AT 183

THIS ANALYSIS HAS PERFECT APPLICATION TO THIS INSTANT MATTER. TAXPAYER CONTRACTS WITH VARIOUS CUSTOMERS TO CREATE OR IMPROVE REAL ESTATE. SEE JOINT STIP. EX. NO. 1 B-E THE FACT THAT THE CUSTOMER SUPPLIES THE SPECIFICATIONS DOES NOT CHANGE THE BASIC FACT THAT THE CUSTOMER CONTRACTS FOR A FINISHED PRODUCT.[4] IN SATISFYING ITS CONTRACTUAL OBLIGATIONS TO CREATE OR IMPROVE REAL ESTATE, THE IDENTITY OF THE ASPHALT, AS EMPLOYED BY THE TAXPAYER, IS DESTROYED AS PERSONAL PROPERTY IN ITS CONVERSION TO REAL ESTATE. AND, AS IN LYON, TAXPAYER'S USE OF THE ASPHALT TAKES THE MATERIAL OFF THE RETAIL MARKET.

THUS, SINCE TAXPAYER PRIMARILY USES THE ASPHALT IN FULFILLING ITS CONTRACTS AS A CONSTRUCTION CONTRACTOR MAKING IMPROVEMENTS TO REAL ESTATE, THE ASPHALT IS NOT MANUFACTURED PRIMARILY FOR WHOLESALE OR

This, of course, dispenses with taxpayer's argument that it's "use" of the asphalt occurs only if it employed the asphalt on property it, itself, owned or leased. (Taxpayer's Memorandum of Law, pp. 7-8) See also T.M. Madden & Co. v. Department of Revenue, 272 Ill. App.3d 212 (2nd Dist. 1995) (what the construction contractor was selling to the Illinois Department of Transportation was a road, not ready-mix concrete which the paver manufactured into acceptable roadway material)

[4]. The testimony at the administrative hearing in the Madden case, which is part of the record reviewed by the Appellate Court, provides that Madden created the roadways pursuant to the exacting specifications of the Illinois Department of Transportation. In fact, the contracts that are offered into this record provide for the work to be done according to the "Standard Specifications for Road and Bridge Construction" adopted July 1, 1988 by the Illinois Department of Transportation. These are the standard specifications pursuant to which all of Illinois Department of Transportation work is to be done, and, when adopted by other entities, these specifications become the requirements for those contracts, also. The fact that Madden constructed its roadway according to exacting specifications did not affect the Appellate Court's determination that the product sold to the Illinois Department of Transportation was a road, not a certain amount of construction material. T.M. Madden & Co. v. Department of Revenue, *supra* at 218

RETAIL SALE OR LEASE. THEREFORE, THE MACHINERY AT ISSUE HEREIN FAILS TO QUALIFY FOR THE EXEMPTION SOUGHT.

TAXPAYER GIVES SHORT SHRIFT TO MATERIAL SERVICE CORP., LYONS & SONS AND CRAFTMASTERS BY ATTEMPTING TO DISTINGUISH THE FACTS OF THOSE CASES TO THE FACTS BEFORE ME. WHILE THOSE CASES INVOLVE HOME BUILDERS AND REMODELERS, AS OPPOSED TO ROAD CONSTRUCTION CONTRACTORS, THE BASIC LEGAL PRINCIPLE REMAINS THE SAME.

THE TAXPAYER IGNORES THE FACT THAT THE CASES CITED DIRECTLY ADDRESS THE ISSUE HERE, VIZ, IS THERE A WHOLESALE OR RETAIL SALE OR LEASE OF THE ASPHALT PRODUCED BY THE SUBJECT MACHINERY. THESE CASES UNEQUIVOCALLY STATE THAT, AS A CONSTRUCTION CONTRACTOR, TAXPAYER'S USE OF THE ASPHALT CONSTITUTES ITS OWN USE OF THE PROPERTY. THE AUTHORITIES CITED ARE MANIFEST ON THE POINT THAT A CONSTRUCTION CONTRACTOR, IN CREATING OR IMPROVING REAL ESTATE, DOES NOT MAKE A SALE OF THE MATERIAL TO ITS CUSTOMER. INSTEAD, IT USES THE MATERIAL IN SATISFACTION OF ITS OBLIGATIONS TO CREATE OR IMPROVE REAL ESTATE.

THE TAXPAYER PLACES SIGNIFICANT RELIANCE ON THE CASE OF DUNN COMPANY, A DIVISION OF TYROLT, INC. V. DEPARTMENT OF REVENUE, 91 MR 77, A CASE DECIDED IN NOVEMBER, 1992 BY THE HONORABLE ROBERT J. EGGERS IN THE CIRCUIT COURT OF SANGAMON COUNTY, ILL. AS A TECHNICAL MATTER, THE DEPARTMENT CORRECTLY ADVISES THAT THE COURT'S DECISION IN DUNN IS NOT PRECEDENTIAL FOR PURPOSES OF MY RECOMMENDATION IN THIS MATTER.

MORE IMPORTANTLY, HOWEVER, IS THE FACT THAT THE DUNN COURT OFFERS NO INSIGHT, WHATSOEVER, INTO HOW IT CAME TO DECIDE THAT THE EXEMPTION ISSUE BEFORE IT WAS CONTROLLED BY THE HOLDING IN VAN'S MATERIAL COMPANY, INC. V. DEPARTMENT OF REVENUE, 131 ILL.2D 196 (1989). WITH ALL DUE RESPECT TO THE COURT, IT IS MY OPINION THAT THE VAN'S CASE IS APPLICABLE TO ONLY THAT SMALL

portion of taxpayer's operation wherein it acts solely as a retailer of the asphalt to its customers. The taxpayer in Van's was not a construction contractor as is true here. Because the greatest part of taxpayer's business is as a construction contractor, the cases cited above dealing with construction contractor's use of tangible personal property to satisfy their obligations as contractors are controlling. The Dunn court does not address those cases at all. As a result, the taxpayer's reliance on the Dunn decision is misplaced.

By regulation, the Department provides for the same manufacturing and assembling exemption established by statute. At 86 Admin. Code Ch. I, Sec. 130.330, the Department regulations provide that machinery and equipment used in certain activities do not qualify for the exemption. Specifically, the regulation provides, in pertinent part, that:

> d) Primary Use
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> 1) The law requires that machinery and equipment be used primarily in manufacturing or assembling. Therefore, machinery which is used primarily in an exempt process and partially in a nonexempt manner would qualify for exemption. However, the purchaser must be able to establish through adequate records that the machinery or equipment is used over 50 percent in an exempt manner in order to claim the deduction.
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> 2) The fact that particular machinery or equipment may be considered essential to the conduct of the business of manufacturing or assembling because its use is required by law or practical necessity does not, of itself, mean that machinery or equipment issued primarily in manufacturing or assembling....
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> ***
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> 4) By way of illustration and not limitation, the following activities will generally not be considered to be manufacturing:

> a) The use of machinery or equipment in the construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance or improvement of real estate;...
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> e) Product use
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> 1) The statute required that the product produced as a result of the manufacturing or assembling process be tangible personal property for sale or lease. Accordingly, a manufacturer or assembler who uses any significant portion of the output of his machinery or equipment, either for internal consumption or any other nonexempt use, or a lessor who leases otherwise exempt machinery and equipment to such a manufacturer or assembler, will not be eligible to claim the exemption on that machinery and equipment... .

Id.

As part of its assertion that the Department regulations do not accurately reflect the law, the taxpayer has provided, as part of this record, several pieces of correspondence, neither of which was addressed to this instant taxpayer. The first letter, which is Joint Stip. Ex. No. 1 F, forewarns the addressee that the asphalt plant does not, in and of itself, qualify for the exemption. Rather, its use must satisfy the statutory requirements. I concur that in order for an asphalt plant to qualify for the exemption, its use must satisfy the statutory requirements. For the reasons set forth in this recommendation, taxpayer's machinery does not so qualify.

The second letter, appearing as Joint Stip. Ex. No. 1 G, is a 1988 internal memorandum to the then director of the Department of Revenue. Again, it is not an incorrect recitation of the Department's position, at that time, regarding the exemption of machinery and equipment used by construction contractors. Taxpayer asserts that the Department's recognition that the machinery used by an entity, such as was the case in

Van's where the tangible personal property manufactured and sold at wholesale or retail qualifies for the exemption and the same machinery used by a construction contractor who makes no wholesale or retail sales of tangible personal property does not, creates an unconstitutional infirmity in the interpretation of statute.

The taxpayer's constitutional analysis is incorrect. The Department's regulations do not violate the Illinois Constitution. The seminal case in Illinois for an analysis of a revenue statute against a constitutional challenge is Searle Pharmacy v. Department of Revenue, 117 Ill.2d 454 (1987). In Searle, taxpayers challenged a particular amendment to a section of the Illinois Income Tax Act as being violative of the equal protection clauses of the U.S. Constitution and the Illinois Constitution, and the uniformity clause of the Illinois Constitution. The Searle court said that for purposes of a challenge to a non-property tax based upon both equal protection and uniformity arguments, the appropriate test to be applied to the suspect classification is the same. That is, "the classification must be based on a real and substantial difference between the people taxed and those not taxed, and that the classification must bear some reasonable relationship to the object of the legislation or to public policy." (Emphasis in the original) Id. at 468

Pursuant to the application of this test, the fact that an asphalt plant is exempt as a company which conducts its business as did the Van's taxpayer, and is not exempt with regards to a company which conducts its business as a construction contractor, does not render the Department's regulations unconstitutional.

I do not disagree that a plain reading of the pertinent exemption statute is that the legislature intended to give sales tax relief for

MANUFACTURING EQUIPMENT AND FOR NEW AND OLD INDUSTRY IN ILLINOIS. VAN'S MATERIAL CO. V. DEPARTMENT OF REVENUE, SUPRA AT 196 HOWEVER, AS AN ADJUNCT TO THIS PREMISE, THE TAXPAYER COMPLETELY IGNORES THE FACT THAT THE ILLINOIS LEGISLATURE ALSO INTENDS TO TAX THE USE AND CONSUMPTION OF TANGIBLE PERSONAL PROPERTY. 35 ILCS 105/2, 105/3 THE EXEMPTIONS FOUND IN THE USE TAX ACT CARVE OUT CERTAIN EXCEPTIONS TO THE GENERAL TAXING PURPOSE, BUT THESE TAX EXEMPTIONS ARE STRICTLY CONSTRUED AGAINST THE TAXPAYER AND IN FAVOR OF THE TAXING BODY (TELCO LEASING, INC. V. ALLPHIN, 63 ILL.2D 305 (1976)), WITH ALL DOUBTS BEING RESOLVED IN FAVOR OF TAXATION. FOLLETT'S ILLINOIS BOOK & SUPPLY STORE, INC. V. ISSACS, SUPRA AT 606 "INDEED, THE PRESUMPTION IS AGAINST THE INTENT TO EXEMPT THE PROPERTY FROM TAXATION." VAN'S MATERIAL CO. V. DEPARTMENT OF REVENUE, SUPRA AT 216 (CITING UNITED AIR LINES, INC. V. JOHNSON, 84 ILL.2D 446, 456 (1981))

IN LIGHT OF THESE SUPREME COURT DIRECTIVES AND THE STATUTE, THE LANGUAGE OF THE PERTINENT EXEMPTION IS CLEAR. THERE IS SIMPLY NO QUESTION THAT THE EXEMPTION IS NOT A BLANKET ONE FOR ALL MACHINERY USED TO MANUFACTURE TANGIBLE PERSONAL PROPERTY. THE EXEMPTION APPLIES ONLY WHEN THE MACHINERY IS USED PRIMARILY TO MANUFACTURE TANGIBLE PERSONAL PROPERTY FOR WHOLESALE OR RETAIL SALE OR LEASE. 35 ILCS 105/3-5 (18)

THE NEXT INQUIRY IS WHETHER THERE IS A REAL AND SUBSTANTIAL DIFFERENCE BETWEEN THE RETAILER OF ASPHALT MANUFACTURED BY THE ASPHALT PLANT (VAN'S) WHO QUALIFIES FOR THE EXEMPTION WITH REGARDS TO THE PLANT, AND A CONSTRUCTION CONTRACTOR WHO USES THE ASPHALT PRODUCED TO SATISFY ITS CONTRACTUAL OBLIGATIONS TO CREATE OR IMPROVE REAL ESTATE, SUCH AS IN THE INSTANT CASE.

THE TAXPAYER IN VAN'S AND THE TAXPAYER HEREIN ARE NOT SIMILARLY SITUATED. HAD THEY BEEN, A CONSTITUTIONAL PROTECTION FOR DISPARATE

treatment would be provided. Differences exist by the mere fact that these two entities are engaged in two different businesses, a reality recognized by Illinois courts. The Van's type manufacturer is a retailer of tangible personal property. In contrast, the Illinois Supreme Court, in G.S. Lyon & Sons Co. v. Department of Revenue, 23 Ill.2d 177 (1961) and Material Service Corp. v. Issacs, 25 Ill.2d 128 (1962) unequivocally held that construction contractors are the "users" not the retailers, of the materials they employ to satisfy their contractual obligations to improve real estate. Accord, Craftmasters, Inc. v. Department of Revenue, 269 Ill. App.3d 934 (4th Dist. 1995)

Therefore, the facts in this matter are unlike those in Commercial National Bank v. City of Chicago, 89 Ill.2d 454 (1982), cited by the taxpayer, wherein the defendant placed a tax on certain commercial entities which were in the commodity and securities business, while exempting other entities in the same business, but offering their services in an noncommercial arena. The Illinois Supreme Court found that this was impermissible in that the taxed and non-taxed entities were in the same business and offered the same services.

Taxpayer's primary business is not the same as that of a retailer of tangible personal property. As a construction contractor, it does not sell asphalt to the Illinois Department of Transportation. It contracts with the Illinois Department of Transportation and all similar customers to construct roads or improvements to real estate. (See T.M. Madden & Co. v. Department of Revenue, supra)

As a result, the taxpayer's argument that the Department's reading of the law gives a constitutionally impermissible economic advantage to the asphalt retailer is without substance. In an analysis of

whether a regulation is constitutional, the fact that one entity benefits economically over a dissimilar entity is not a consideration, nor should it be.

It is in this area where taxpayer's arguments encounter problems. The taxpayer points out that in Joint Stip. Ex. No. 1 G, the Department acknowledges that an entity which carries on two distinct businesses, such as taxpayer, would benefit from the exemption for asphalt plants if it divided into two separate entities, with the retail entity purchasing the machinery and thus qualifying for the exemption. The Department's recognition of this situation is neither "encouraging the establishment of a distinction without a difference in order to obtain substantial tax benefits" or "recognizing a legal loophole created by its tortured effort to avoid the statutory exemption" as proposed by this taxpayer.

Federal tax laws and Illinois tax laws are abundant with provisions which provide different tax treatment for different entities. For example, a taxpayer can organize itself as a partnership as opposed to a corporation as opposed to a sub-chapter S corporation. One may choose to be a "wholesaler" versus a "retailer", a lessor or a lessee of tangible personal property pursuant to a lease or a conditional sales contract. The tax ramifications differ in each situation.

It is not unreasonable to presume that the decision to organize in one of these forms is made with a view to the type and manner of how one receives income, and to how to maximize one's income. In fact, "it must be emphasized that nothing in the revenue statues prevents a taxpayer from legally minimizing, in contrast to evading, his, her, or its taxes." Burlington Northern, Inc. v. Department of Revenue, 32 Ill. App.3d 166, 177 (1st Dist. 1975) The limitation, however, is that although a "taxpayer may

PROPERLY ARRANGE ITS AFFAIRS TO MINIMIZE TAXATION" (UNITED STATES GYPSUM CO. V. UNITED STATES, 452 F.2D 445, 451 (7TH CIR 1971)), THERE IS THE CAUTION THAT THE ENTITY DOES NOT HAVE THE RIGHT TO "CREATE PURPOSELESS ENTITIES OR TO ENGAGE IN TRANSACTIONS WITH SUBSIDIARIES WHICH INDEPENDENT PARTIES WOULD NOT DREAM OF CONCLUDING." ID.

TAXPAYER CONDUCTS TWO DISTINCT TYPES OF BUSINESSES. FIRST, IT MANUFACTURES ASPHALT WHICH IT SELLS AT RETAIL. SECONDLY, IT USES ASPHALT AND OTHER MATERIALS TO CREATE OR IMPROVE REAL ESTATE, THEREBY ACTING AS A CONSTRUCTION CONTRACTOR. TO ORGANIZE ITSELF TO REFLECT THESE TWO DISTINCT ACTIVITIES WOULD NOT BE PURPOSELESS, AND, IF THE RETAILER TAXPAYER CONDUCTS BUSINESS WITH THE CONSTRUCTION CONTRACTOR TAXPAYER AS IT DOES WITH OTHERS, THEIR TRANSACTIONS ARE NOT SUSPECT. TAXPAYER WOULD BE IN THE SAME POSITION AS ALL OTHER MANUFACTURERS OF TANGIBLE PERSONAL PROPERTY WHO SELL THEIR PRODUCT AT WHOLESALE OR RETAIL AND WOULD BE ABLE TO CLAIM THE SAME EXEMPTIONS STATUTORILY PERMITTED TO THEM. TAXPAYER WOULD ALSO BE IN THE SAME POSITION AS ALL OTHER CONSTRUCTION CONTRACTORS WHO ARE IN THE BUSINESS OF CREATING OR IMPROVING REAL ESTATE, SUCH AS THE TAXPAYER IN T.M. MADDEN. THIS CERTAINLY IS NO MORE OR NO LESS THAN AN ACCURATE REFLECTION OF WHAT TAXPAYER ACTUALLY DOES.

NOR IS THE CONCEPT OF MAKING BUSINESS DECISIONS IN A MANNER WITH A VIEW TO TAX CONSEQUENCES FOREIGN TO TAXPAYER. AT HEARING, TAXPAYER'S PRESIDENT, WITNESS, TESTIFIED AS FOLLOWS ON EXAMINATION BY THE DEPARTMENT'S COUNSEL:

> Q: NO, I'M ASKING YOU IF YOU WOULD TAKE, YOU WOULD CONSIDER THE TAX CONSEQUENCES OF HOW YOU ORGANIZE OR WHO YOU DO BUSINESS WITH WHEN YOU MAKE BUSINESS DECISIONS?

> A: I would at the time I make the business decision if I knew that I am making a business decision a certain way would save the company money, then naturally we try to factor that in and take that into consideration and make the best business decision for the company.

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The fact that taxpayer has not organized its two businesses in a manner which is most advantageous for tax purposes is not an indictment of the tax statutes nor the department regulations interpreting them. This seems to be taxpayer's complaint which is without substance.

Taxpayer concludes its memorandum of law with an accusation against the department that the time that it has taken for this instant case to make its way through this administrative process results from the department's refusal to apply the Supreme Court's holding in the Van's case or the Circuit Court's decision in Dunn. Since this is not a substantive argument, it does not require a response. However, I will make some brief comments.

The taxpayer desperately wishes a determination that it's purchase of the asphalt plant fits into the use tax exemption and it asserts that it does so because it is indistinguishable from the taxpayer in Van's. I cannot make this recommendation as the facts in this case demonstrate that taxpayer manufactures the asphalt primarily for its own use, thereby removing itself from the application of the exemption sought. I agree with the department that use tax is due on the item. Therefore, not only is there no evidence that the department unjustly refuses to apply Van's in this matter, legally, Van's does not even remotely apply, much less govern the outcome.

The same is true with the Dunn decision. For the reasons articulated herein, that case is not dispositive of this matter for no less reason than

IT OFFERS NO RATIONALE FOR THE COURT'S DETERMINATION. AGAIN, IT IS NOT A QUESTION OF REFUSING TO APPLY THE CASE, RATHER, DUNN NEED NOT BE, NOR CAN IT BE APPLIED HEREIN.

THERE IS NOTHING NEFARIOUS NOR "HARASSING" ABOUT THE DEPARTMENT REFUSING TO GRANT AN EXEMPTION FROM THE APPLICATION OF A TAX IF THE DEPARTMENT REASONABLY BELIEVES THE TAX IS LEGALLY DUE. BECAUSE OF DIFFERENCES IN LEGAL OPINIONS BETWEEN THE DEPARTMENT AND TAXPAYERS, THE LEGISLATURE HAS PROVIDED FOR A SIGNIFICANT REVIEW PROCESS AVAILABLE TO BOTH PARTIES. IT IS AS A RESULT OF THAT PROCESS THAT TAXPAYERS HAVE, ON MANY OCCASIONS, PREVAILED IN THEIR CLAIMS JUST AS THE DEPARTMENT HAS PREVAILED USING THAT SAME PROCESS. SEE T.M. MADDEN & CO. V. DEPARTMENT OF REVENUE, SUPRA AT 217 (STATING THAT PLAINTIFF'S RELIANCE OF VAN'S MATERIAL CO. IS MISPLACED).

IT IS WELL-SETTLED IN ILLINOIS THAT TAX EXEMPTION PROVISIONS ARE STRICTLY CONSTRUED AGAINST THE TAXPAYER AND IN FAVOR OF THE TAXING BODY (TELCO LEASING, INC. V. ALLPHIN, 63 ILL.2D 305 (1976)) WITH THE EXEMPTION CLAIMANT HAVING TO CLEARLY PROVE ENTITLEMENT TO THE EXEMPTION (UNITED AIR LINES, INC. V. JOHNSON, 84 ILL.2D 446 (1981)) WITH ALL DOUBTS BEING RESOLVED IN FAVOR OF TAXATION ID. AT 455 AS I STATED EARLIER, THE PRESUMPTION IS AGAINST THE INTENT TO EXEMPT THE PROPERTY FROM TAXATION. ID. AT 456.

TAXPAYER HEREIN HAS FAILED TO CLEARLY PROVE ITS ENTITLEMENT TO THE EXEMPTION IT SEEKS.

I THEREFORE RECOMMEND THAT THE DIRECTOR OF THE DEPARTMENT OF REVENUE UPHOLD THE NOTICE OF TAX LIABILITY IN ITS ENTIRETY; REDUCE THE AMOUNT OF THE TENTATIVE DENIAL OF THE CLAIM FOR CREDIT BY $9,981.00, THE AMOUNT ATTRIBUTABLE TO THE TAXES AND INTEREST PAID FOR POLLUTION CONTROL

EQUIPMENT FACILITIES; AND UPHOLD THE REMAINDER OF THE AMOUNT OF THE TENTATIVE DENIAL OF THE CLAIM FOR CREDIT IN ITS ENTIRETY.

RESPECTFULLY SUBMITTED,

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BARBARA S. ROWE
ADMINISTRATIVE LAW JUDGE

MARCH 27, 1996